Application of General Principles of Law

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I. INTRODUCTION

In recent years, an increasing number of contracts provides that the agreement of the parties be governed not by any national law, but by rules beyond national law such as generally accepted principles, principles common to several or all legal systems, rules or principles of (public) international law, trade usages or lex mercatoria. At the same time, arbitrators themselves decide more and more often to apply to the dispute before them such transnational rules, either alone or in combination with each other or with a system of national law.

The present Report deals only with general principles of law as applied in international arbitration. While there is no commonly shared understanding of the concepts of other transnational rules, their nature and their place in the international legal order, either in arbitral practice or in the scholarly debate of the law applicable in international arbitration, the differences of opinion with respect to general principles of law relate not so much to the legal foundations from which they may be derived, but rather to their contents and the extent to which they may be applied in different circumstances. While much of the debate centers around the aspect of the applicable law, i.e. what the sources of the principles are, how their contents can be determined and to what extent awards based on them are enforceable, this Report concentrates on the application of general principles of law in the practice of arbitration and the specific meaning they have been given in different circumstances.

Considering that other Reports are included on these subjects, general principles of private international law are not discussed here. For the same reason this Report does not address those features of general principles that are peculiar to the context of public international law or the specific aspects in case of the involvement of state parties. Most importantly, since the concept of lex mercatoria as an application of transnational law is examined elsewhere, the present Report is only concerned with general principles that are common to and derived from national legal systems, and it does not deal with principles suggested to be part of lex mercatoria but which have their foundation in sources other than national laws.

II. SPECIFIC PRINCIPLES APPLIED

While certain very general principles are so widely accepted that they are found in all legal systems, general principles of
law show an increasing tendency towards specialization, as Emmanuel Gaillard concluded in his introduction to a recent study of specific transnational rules. In order to focus on these more "difficult" areas, the following enumeration therefore elaborates on these "specialized" aspects of general principles of law rather than on fundamental maxims that can be said to underlie whole legal systems. In that way, it also addresses the concern that it is often not possible to determine with sufficient precision the content of a particular principle.

1. Pacta Sunt Servanda and Changed Circumstances

The sanctity of the contract is a cornerstone of the law of contract. Parties must adhere to the terms of their contract. Arbitrators must respect the contract and apply the terms that the parties have agreed upon. Often, pacta sunt servanda has been referred to by arbitrators as a basic principle of law. More frequently, arbitral awards impliedly recognize the principle simply by applying the contractual terms to the dispute.

The rule complementary to the sanctity of the contract, namely the clausula rebus sic stantibus, while recognized as a general principle of law, must be and has been applied with caution and in a restrictive manner. Most national legal systems contain the rule that changed circumstances may affect the binding force of a contract.

As expressed by the Iran-United States Claims Tribunal:

"The concept of changed circumstances, also referred to as rebus sic stantibus, has in its basic form been incorporated into so many legal systems that it may be regarded as a general principle of law; it has also found a widely recognized expression in Article 62 of the Vienna Convention on the Law of Treaties."

Although this latter provision applies to treaties between States, it contains a succinct description of the concept and particularly its exceptional character that can provide guidance also for arbitrators. Art. 62 states:

"A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of the treaty, and which was not foreseen by the parties, may not be involved as a ground for terminating or withdrawing from the treaty unless: (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of the obligations still to be performed under the treaty".

Arbitrators have been strict in their application of the clausula. One reason is that participants in international business transactions can be expected to be knowledgeable and mindful of changes that might occur after they have entered into a contract. The acceptance only of a change in circumstances that has been substantial enough to affect the whole contract balance serves as another restricting factor.

Absent contractual provisions allowing for renegotiation or contract adaptation, depending on the circumstances, the remedies generally available under the clausula are suspension or termination of the contract. Exceptionally, compensation was granted to a contractor who, faced with a severe penalty clause, had continued to perform under the contract notwithstanding changed circumstances that made his contract performance more difficult, but had at the same time notified the other party that he would claim compensation for the additional work he would perform.

2. Force Majeure

There is consensus in principle on a doctrine of force majeure "that operates to excuse the performance of contractual obligations when unforeseen events beyond the party's control occur which make the party's performance impossible." In his recent report on lex mercatoria and force majeure, David Rivkin finds, mostly from an extensive comparison of all major municipal legal systems in this area, that there is
"an overlapping consensus on a doctrine that operates to excuse the performance of contractual obligations when unforeseen events beyond the party's control occur which make the party's performance impossible. However, there are substantial differences among national laws as to the nature of events that qualify, whether or not extreme impracticability is sufficient, and the nature of relief."11

While the lex mercatoria of force majeure has thus not yet "crystallized into an algorithmic formula for determining when a party ought to be excused from performing contractual duties",12 international arbitration does recognize a common core of the doctrine as a general principle of law. An analysis of ICC awards that have dealt with the issue has led Werner Melis to conclude that "ICC arbitrators apply at least the same restrictive criteria for admission of force majeure or hardship as do courts in the country whose law they apply.13 David Rivkin's analysis confirmed14 that the trend in ICC arbitrations has been to interpret excuse doctrines in a restrictive manner and to accept a plea, such as that of force majeure, only reluctantly. The arbitrators in any case satisfy themselves that the two main requirements, i.e. impossibility and foreseeability, have been fulfilled. The presumption of competence on the part of the participants in international business transactions, as well as the primacy given to the intent of the parties as expressed in the contract, are also in the case of force majeure further restricting factors.

Considering the volume and extent of the revolutionary changes in Iran during 1979/80, it is not surprising that the doctrine of force majeure has played a significant role in the cases before the Iran-United States Claims Tribunal. In its application of force majeure, the Tribunal relied almost entirely (either implicitly or explicitly) on general principles. This was probably enhanced by the Tribunal's reluctance to apply the law of either party and its "tendency to analyze contract termination issues in terms not requiring findings of breach".15 The Tribunal recognized force majeure as a general principle of law authorizing full or partial suspension or termination of a contract even if it does not contain a force majeure clause. The fact that different approaches to the character and consequences of the force majeure conditions in Iran at the time are reflected in some of the awards does not necessarily diminish their contribution to the development of the principle, as long as the circumstances warranted a more qualified treatment. The best example of such a case-specific and more cautious approach can be found in the Sylvania case where the Tribunal emphasized that a force majeure defence "must always be analyzed in the context of the circumstances causing force majeure, taking into account the particular party affected by those circumstances and the specific obligations that party is prevented from performing".16

The particular problems (also dealt with by the Tribunal) that arise in cases where force majeure is invoked by or against a State party are not analyzed here since they are covered in another Report.

3. Other Principles Related to Contracts

The awards of the Iran-United States Claims Tribunal also illustrate the application of general principles related to other contract issues.17 General principles have regularly been applied to find or confirm the existence of contracts. Many cases apply the rule that performance by one party at the instigation or with the knowledge or acquiescence of the other creates or confirms the existence of a contract. It was found to be a general principle that a party may not deny the validity to a contract entered into on its behalf by another if by its conduct, the latter consents to the contract. Similarly, the Tribunal has characterized as a general principle and has applied the concept of "account stated".18 Several times it has referred to general rules of contract interpretation which dictate that contracts are to be interpreted so as to give meaning to their texts as a whole, and that contracts should be construed contra preferentem.

Discrete issues for the determination of which the Tribunal had recourse to general principles refer, inter alia, to: suspension of an obligation when a promissory note is given for the obligation; no direct rights of a subcontractor as against the party with whom the contractor has a contract; situations in which a party may not involve a limitation - of liability clause; no one should be allowed to reap benefits from their own wrong; request for transfer of funds required before bank obligated to effect such transfer."19
The Iran-United States Claims Tribunal is a useful source for the topic of this Report both for the volume and variety of its jurisprudence and because all its decisions are published and accessible. Although it is less of an arbitral body and has only recently started functioning fully, another international claims settlement institution should be mentioned in this context since there are already several references in its work to general principles of law, and it can be expected that such references will become more frequent and elaborate as the number of decisions rendered increases. The United Nations Compensation Commission which deals with claims for losses resulting from Iraq's invasion and occupation of Kuwait in 1990/91 has both in the criteria which guide its work and in its first decisions on claims made references to general principles of law.

In the criteria that the Commission's Governing Council adopted for the compensation of business losses, references are made in several places to general principles particularly of contract law. The first report of the Panel of Commissioners dealing with claims for departure from Iraq or Kuwait, for instance, contains a statement to the effect that "international law and jurisprudence ... recognize the principle that interest should be paid on the principal amount of awards to make successful claimants whole for their losses" (footnote omitted). In the view of the Commissioner Panel, this principle supports the following criteria issued by the Governing Council: "Interest will be awarded from the date the loss occurred until the date of payment, at a rate sufficient to compensate successful claimants for the loss of use of the principal amount of the award."

The extensive jurisprudence concerning interest that international arbitration has produced has not resulted in a consistent approach or generally accepted rules on this subject, as Pierre Karrer found when he examined whether a transnational law of interest exists.

The Panel of Commissioners dealing with with injury and death claims decided a particular issue in connection with the definition of family, inter alia, "in conformity with general principles of private international law". And the Panel of Commissioners dealing with individual claims for damages up to US$ 100,000 referred in its first report in several instances to general principles of law.

4. Damages

The question what the damages are that are compensable raises a host of issues with which many arbitral tribunals have to deal. The most categoric and explicit pronouncement on the role of general principles of law in this field comes again from the Iran-United States Claims Tribunal which stated that it "prefers to analyze the damage questions in accordance with general principles of law", rather than by reference to the law chosen by the parties in the particular case. In fact, however, the tribunal based its decisions with respect to damages in many cases on the contract and there was therefore no need to resort to general principles. From the jurisprudence of other arbitral tribunals it is hardly possible to derive truly general principles of law in this area, rather there are often not insignificant differences between the various solutions put forward.

An exception is the obligation to mitigate damages which has been described as the most firmly established rule of even the lex mercatoria and which has become consistent factor in ICC awards over the years.

5. Unjust Enrichment

The concept of unjust enrichment (quantum meruit) is in one form or another known in virtually every legal system. It rests on basic notions of justice and equity, becoming relevant where other rules would lead to an unjust result. Quantum meruit played an important role in the jurisprudence of the Iran-United States Claims Tribunal which emphasized every time it applied the concept that it was a general principle of law. The Tribunal elaborated on various aspects of the concept in a number of decisions, including the interplay between unjust enrichment and contractual remedies. The conditions that must be present for the principle to apply are best summarized in the Tribunal's Sea-Land award:

"There must have been an enrichment of one party to the detriment of the other, and both must arise as a consequence of the same act or event. There must be no justification for enrichment, and no contractual or other remedy available to the injured party whereby he might seek compensation from the party enriched."
6. Estoppel

“At the heart of estoppel is the notion that one party to a dispute should not be permitted to take a position, including by asserting legal rights, in circumstances where (i) were he to do so, that party would be acting in a manner inconsistent with a position he had previously taken and (ii) it would be unjust to the other party for him to do so.”

The notions underlying this concept find similar expression in the concepts of "l'interdiction de se contredire au détriment d'autrui" and non concedit venire contra factum proprium, and these principles are generally accepted rules both of public international law and of the general principles of law. Important cases where estoppel has been considered in international commercial disputes have involved States and State enterprises. Paul Bowden’s examination covers the following cases in more detail: Amco Asia (award on jurisdiction by the first tribunal), Framatome, Dalmia Dairy and Benteler, as well as two cases decided by the Iran-United States Claims Tribunal (DIC of Delaware and Woodward-Clyde), He wonders whether estoppel is a concept which is capable of being elaborated into substantive and detailed rules or whether it is rather a technique which applies, albeit in a focused way, to the vague notion of good faith. I am slightly more optimistic hoping that this could be one of the general principles that can lend itself to more precise definitions and a more predictable application, with the DIC of Delaware case cited by Paul Bowden being a good example where, based on a rather detailed analysis of a party's conduct (taking into account pre-contractual negotiations and acceptance of substantial part-performance), that party was found to be estopped from asserting the non-existence of the contract.

III. ENFORCEABILITY OF AWARDS BASED ON GENERAL PRINCIPLES OF LAW

A brief concluding remark relating to an important consideration. International arbitrators must ensure that their awards can be executed as widely as possible. They have to observe that the principles they apply are acceptable as part of the law in as many countries as possible and that the execution of the resulting awards will not be made doubtful or impossible by their choice of the applicable law. In this respect, the two situations foreseen in the International Law Association's Cairo Resolution of 1992 concerning Transnational Rules should cause no problems for the validity or enforceability of awards that are based on general principles of law: The fact that an international arbitrator has based an award on general principles of law should not in itself affect the validity or enforceability of the award (1) where the parties have agreed that the arbitrator may apply general principles of law; or (2) where the parties have remained silent concerning the applicable law.


1 Unlike the rules referred to by lex mercatoria, there is no disagreement as to the legal character of the general principles of law. Cf., e.g., the conclusion in the study of Veijo HEISKANEN, “Applicable Law in International Commercial Arbitration”, Finnish Yearbook of International Law (1993) pp. 98-129, 128.


3 This is most prominent in awards involving disputes with State parties. In the Sapphire case, the tribunal stated: “It is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual undertakings must be respected. The rule pacta sunt servanda is the basis of every contractual relationship”, ILR (1967) pp. 136 et seq. at p. 181. The arbitrator in the Liamco case summarized his references to a number of municipal laws stating: “The principle of the sanctity of contracts ... has always constituted an integral part of most legal systems”. ICCA Yearbook Commercial Arbitration VI (1981) p. 89 et seq. at p. 101.

4 The terms used in the various legal systems vary as do the precise conditions and consequences of the principle. See, e.g., frustration (of purpose), imprevisión, Wegfall der Geschäftsgrundlage.

5 Questech, Inc. v. Ministry of National Defence of the Islamic Republic of Iran, 9 Iran-U.S. C.T.R. (1985 II) pp. 1 et seq., 122-123. While the Tribunal was careful to justify the contract termination based on the sensitive nature of the government contract at issue, it was assisted in its decision by the inclusion of the term "changed circumstances" in the applicable law provisions which meant that "changes which [were] inherent parts and consequences of the Iranian


The ICC has published rules on contract adaptation, ICC publication No. 326.


*RIVKIN, op. cit. note 10*, p. 201.

*John CROOK*, "Applicable Law in International Arbitration: The Iran-United States Claims Tribunal Experience", *American Journal of International Law* (1989) pp. 278-311 at p. 293. This jurisprudence was, on the other hand, certainly in line with the applicable law provision which stipulates that: "[t]he Tribunal shall decide all cases on the basis of respect for law, applying such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances." (Claims Settlement Declaration, Art. V).


While the Tribunal's jurisdiction also extends to governmental disputes under public international law, the majority of the cases before it are commercial claims the bulk of which involve contractual issues. For the mixed nature of the Tribunal see *David CARON*, The Nature of the Iran-United States Claims Tribunal and the Evolving Structure of International Dispute Resolution, *American Journal of International Law* (1990) p. 104 et seq.

"It is a well-established general principle in various legal systems that in commercial relationships one party may be obligated to pay another party, with which it has been doing business, a sum specified in an invoice if it receives the invoice but does not object to it within a certain period of time." *Dames and Moore v. Iran*, 4 Iran U.S. C.T.R. (1983 III) pp. 212 et seq. at p. 221.

For a short summary of the many contractual issues that the Tribunal dealt with, see *Norbert WUHLER*, *Zur Bedeutung des Iran United States Claims Tribunal für die Rechtsfortbildung durch Internationale Schiedsgerichtsbarkeit* (1989) pp. 93-124.

The Commission is a subsidiary organ of the U.N. Security Council established to process claims arising from Iraq's invasion and occupation of Kuwait and to administer a fund to pay compensation for such claims. The broad policies and guidelines are set by a Governing Council which consists of fifteen members at any given time of the Security Council; the claims are reviewed and compensation is determined by Panels of Commissioners; and the amounts of the awards are approved by the Governing Council. The Commission is to a certain extent a political organ, performing administrative mass claims processing, particularly with respect to the more than 2 million individual claims before it. While the decisions on these already specify a number of legal standards and procedures, the work on the thousands of corporate and government claims with a total value of more than USS 120 billion will resemble even more the concepts and procedures used in international commercial arbitration.


Although, according to the Iran-United States Claims Tribunal, the international precedents reflect a rule to the effect that compound interest is not allowed. *R.J. Reynolds Tobacco Company v. Iran*, 7 Iran-U.S. C.T.R. (1984 III) p. 181 et seq. at p. 191.


Report and Recommendations Made by the Panel of Commissioners Concerning the First Instalment of Individual
Referring Principles:

- I.1.2 - Prohibition of inconsistent behavior
- II.4 - Agency by estoppel / apparent authority
- IV.1.2 - Sanctity of contracts
- IV.2.2 - Silence by offeree
- IV.5.4 - Interpretation against the party that supplied the term
- IV.5.2 - Context-oriented interpretation
- VI.3 - Force majeure
- VII.4 - Duty to mitigate
- VIII.1 - Definition
- VII.6 - Duty to pay interest
- IX.1 - Basic rule